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UNDP FINANCIAL RISK MANAGEMENT: REVIEW OF THE OPERATIONAL RESERVE

Report of the Advisory Committee on Administrative and Budgetary Questions

1. The Advisory Committee on Administrative and Budgetary Questions has considered the report of the Administrator of the United Nations Development Programme (UNDP) on UNDP financial risk management, including a review of its operational reserve (DP/1999/5). During its consideration of the report, the Committee met with representatives of the Administrator.

2. The report of the Administrator contains an analysis of the nature of financial risks faced by UNDP, reviews the operational reserve requirements for regular resources and makes recommendations for a revised formula to set the level of the operational reserve. The Administrator recommends that the level of the reserve be set at $206 million for the current biennium, an increase of $26 million from $180 million calculated by the current formula (see paragraph 3 below) (DP/1999/5, paras. 9 and 36). The report also addresses the need to establish a reserve for other resources activities and the mechanism for its funding. Based on a formula described in chapter IV of the report, it recommends the establishment of a reserve at $49 million for other resources activities to be funded through a transfer from the extrabudgetary account, in accordance with an appropriate cost-recovery modality (DP/1999/5, para. 54).

3. Paragraphs 3 to 9 of the report provide a historical summary of developments of the operational reserve requirements of UNDP, leading to the current status. Currently, the operational reserve is set at 20 per cent of estimated voluntary contributions or projected expenditure, whichever is higher, in accordance with Governing Council decision 90/44 of 22 June 1990. Previously, the Governing Council had set the operational reserve level at

25 per cent of the estimated voluntary contributions or expenditures for the year (decision 80/50 of 30 June 1980). On the basis of the current formula, the operational reserve was set at the level of $200 million in 1997 and would be calculated for the biennium 1998-1999 at the level of $180 million, based on the resource projection presented to the Executive Board in the annual review of the financial situation, 1997 (DP/1998/29).

4. The Advisory Committee recalls that the Board of Auditors, in its report on UNDP financial statements and activities for the biennium ended 31 December 1997, reviewed the management of the operational reserve and noted that, in 1997, the level of the reserve was $200 million, in accordance with the established formula. The Board noted that UNDP had used its operational reserve on only one occasion in the past three bienniums, in April 1994, when the delayed receipt of contributions necessitated the temporary utilization of $6.6 million. Moreover, it noted that UNDP had engaged consultants to review the level of its operational reserve and planned to present proposals to the Executive Board accordingly (A/53/5/Add.1, paras. 57-59). In this connection, in its report on financial reports and audited financial statements, and reports of the Board of Auditors, the Advisory Committee was of the opinion that the need to maintain a reserve at the $200 million level should be reviewed (A/53/513, para. 54).

5. The Advisory Committee notes from paragraph 20 of the report that UNDP followed the approach of the United Nations Office of Project Services (UNOPS) to assess risks faced by the organization, recognizing that risks in its operations are different from those of UNOPS. Paragraphs 22 to 27 contain an analysis of the most significant risks faced by UNDP with respect to its regular and other resources. These include risks relating to income, expenditure, assets, liability and those relating to the global character of the UNDP structure and field operations. Based on these risk elements, the Administrator recommends that the formula for the calculation of the operational reserve be amended (DP/1999/5, paras. 30 and 36).

6. The Advisory Committee is of the view that the report does not provide a satisfactory review of the actual experience of the organization with respect to the risk elements identified. The Committee believes that the approach followed by UNDP to assess risks faced by the organization is rather theoretical and, in various instances, judgemental. For example, in paragraph 33, the basis for calculating the liability and structural risk components of the operational reserve are not adequately explained. Both elements are grouped and it is recommended that a "lump sum amount" be established "as 25 per cent of the sum of the income and expenditure components of the operational reserve". In other cases, such as the basis for calculating the cash-flow risks (paras. 34-35), the component of the operational reserve relating to this risk element is assumed to be equal to the cash requirements for one month, based on an analysis of monthly cash flow position over a five-year period. The reasons for this conclusion are not adequately explained in the report.

7. The Advisory Committee notes from paragraph 38 of the report that the Administrator intends to make use of the resources of the operational reserve to minimize the negative effects on programme delivery resulting from any occurrence of the financial risks covered by the reserve. In this connection,

the Committee is of the view that the impact that the increase in the operational reserve may have on the resources available for programmes has not been adequately addressed in the report.

8. Under the circumstances, the Advisory Committee recommends retention of the present formula until such time as the Executive Board decides on another review. Should the Executive Board consider it necessary to re-examine the adequacy of the level of the operational reserve, the Committee will revert to the matter.

9. With respect to the proposal to establish a reserve for other resources activities at the level of $49 million, the Advisory Committee agrees with the proposal for the reasons given in paragraphs 39 to 42 of the report. The Committee notes that, in recognition of the risks relating to the acceptance and management of other resources, UNDP has already been informally reserving a portion of the extrabudgetary income derived from the fees charged by UNDP and that now it would record those funds as a reserve. The Committee was informed that, as at 31 December 1997, an amount of $57.1 million of unallocated resources had been set aside from other resources activities. UNDP proposes to use these funds to establish a reserve; accordingly no additional fund-raising would be required.